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No. 10-838

Supreme Court, U.S.
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In The
Supreme Court of the United States

PACIFIC BELL TELEPHONE COMPANY
d/b/a AT&T CALIFORNIA,

Petitioner,

v.

CALIFORNIA PUBLIC UTILITIES COMMISSION;
MICHAEL R. PEEVEY, TIMOTHY ALAN SIMON,
MICHEL P. FLORIO, and CATHERINE J. K. SANDOVAL,
in their official capacities as COMMISSIONERS OF THE
CALIFORNIA PUBLIC UTILITIES COMMISSION;
and CBEYOND COMMUNICATIONS, LLC,

Respondents.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION AND COMMISSIONERS IN RESPONSE

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QUESTION PRESENTED

Whether section 251(c)(2) of the Telecommunications Act of 1996, 47 U.S.C. § 251(c)(2), and implementing orders of the Federal Communications Commission require incumbent local exchange carriers to lease their entrance facilities to competitive local exchange carriers at regulated, cost-based rates when the competitors use the entrance facilities for the purpose of interconnection.

PARTIES TO THE PROCEEDING

Dian M. Grueneich, John A. Bohn, and Nancy E. Ryan – named as respondents in the petition – are no longer commissioners at the California Public Utilities Commission (CPUC). Ms. Grueneich's and Mr. Bohn's terms expired on December 31, 2010. Ms. Ryan was appointed to another position at the CPUC on or around January 21, 2011. On or around January 25, 2011, Michel P. Florio and Catherine J. K. Sandoval were appointed as Commissioners. Thus, the current Commissioners of the CPUC are Michael R. Peevey, Timothy Alan Simon, Michel P. Florio, and Catherine J. K. Sandoval.[1] Pursuant to Rule 35.3 of the Rules of the Supreme Court of the United States, Commissioners Florio and Sandoval have been automatically substituted as respondents.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of the Supreme Court of the United States, respondents CPUC and the individual Commissioners (Commissioners) state that the CPUC is a governmental entity.

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[1] The fifth commissioner position is vacant at this time.

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STATUTORY AND REGULATORY PROVISIONS INVOLVED

All but two of the relevant provisions of the Telecommunications Act of 1996 (Act) and Title 47 of the Code of Federal Regulations are reproduced in the appendix to AT&T California's petition. The missing provisions – an additional excerpt from 47 C.F.R. § 51.5 and 47 C.F.R. § 51.505 – are set forth in the Appendix to this response.

INTRODUCTION

On September 1, 2010, the United States Court of Appeals for the Ninth Circuit correctly held that competitive local exchange carriers (CLECs) are entitled under the Act and implementing Federal Communications Commission (FCC) orders to use certain incumbent local exchange carrier (ILEC)-owned transmission equipment – called entrance facilities – at regulated, cost-based rates when such entrance facilities are used to interconnect the ILEC and CLEC telecommunications networks. The Seventh and Eighth Circuits agree; in a split decision, the Sixth Circuit does not.

On December 10, 2010, the Court granted certiorari in the Sixth Circuit case in *Talk America Inc. v. Michigan Bell Tel. Co.* (No. 10-313) and *Isiogu v. Michigan Bell Tel. Co.* (No. 10-329) (consolidated). The *Talk America* and *Isiogu* petitions present the same legal question regarding the Act's treatment of

entrance facilities that AT&T California raises in its petition here, as restated by the CPUC and its Commissioners above. *See supra* at i. On February 3, 2011, the CPUC submitted a brief amicus curiae in *Talk America* and *Isiogu* in support of petitioners and in continued support of its own decision ruling that ILECs must provide CLECs with entrance facilities used for interconnection at cost-based rates.

Although the CPUC and its Commissioners waived their brief in opposition to AT&T California's petition in light of the grant of certiorari in *Talk America* and *Isiogu,* the Court requested that the CPUC nonetheless respond to the petition. As set forth below (and in the January 10, 2011 waiver letter), respondents CPUC and its Commissioners believe that the Ninth Circuit reached the correct conclusion in the decision below but respectfully request the Court to hold AT&T California's petition pending the Court's decision in *Talk America* and *Isiogu*.

STATEMENT

Telephone Networks and the Two Uses of Entrance Facilities, Interconnection and Backhaul. In the current local telecommunications market, ILECs have their own separate infrastructures of wires and switches (computers that direct calls to their destinations), called networks, to move calls from one caller to another within their respective

networks. CLECs often have their own networks as well. The telecommunications equipment at issue in this case – called an entrance facility – is a type of transmission facility (*i.e.*, a high capacity wire) that connects ILEC and CLEC networks, such that telephone traffic can transfer seamlessly from one carrier's network to another. *Triennial Review Remand Order (TRRO)* ¶ 136;[2] *Pacific Bell Tel. Co. v. California Pub. Utils. Comm'n*, 621 F.3d 836, 841-42, 844 (9th Cir. 2010), Pet. App. 8a, 13a.[3]

Entrance facilities have two different uses. First, for the telephone system to function, carriers must be able to "interconnect" – that is, calls must be able to move from one carrier's customer (located in that carrier's network) to another carrier's customer (located in the second carrier's network). *Pacific Bell*, 621 F.3d at 842, Pet. App. 8a-9a. *See* Br. Amicus Curiae of CPUC in Supp. of Pet'rs at 3-5, App. 1 (Diagram 1 illustrating example of interconnection), *Talk America*, U.S. No. 10-313, & *Isiogu*, U.S. No. 10-329 (Feb. 3, 2011).

A CLEC also can use an entrance facility to move its own customers' traffic from an ILEC's central office to the CLEC's switch. Using an entrance facility

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[2] Order on Remand, *Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations of Incumbent Local Exch. Carriers*, 20 FCC Rcd. 2533 (2005), *aff'd, Covad Commc'ns Co. v. FCC*, 450 F.3d 528 (D.C. Cir. 2006).

[3] References to "Pet. App." are to the appendix to AT&T California's petition.

in this fashion – to route traffic to and from a CLEC's end users located in the ILEC's service territory – is known as an example of "backhauling" or "backhaul." *Pacific Bell*, 621 F.3d at 842, Pet. App. 9a. With backhaul, no traffic is exchanged between the ILEC and CLEC networks. *See* Br. Amicus Curiae of CPUC at 5-6, App. 1 (Diagram 1 illustrating example of backhaul), *supra* at 3.

Contrary to AT&T California's characterization otherwise, the diagram in the Ninth Circuit's decision – albeit a simplified version of the diagrams the CPUC and AT&T California submitted – accurately depicts what an entrance facility is and its two different functions. *See Pacific Bell*, 621 F.3d at 842, Pet. App. 9a. AT&T California apparently believes the diagram places the entrance facility in, rather than connected to, the ILEC's switching facility (*i.e.*, the tandem office). Pet. for Writ of Cert. 3 n.3. However, it is evident from the text of the decision that the Ninth Circuit understood how an entrance facility works. The court correctly described an entrance facility as a "high capacity wire that links telephone networks" and explained how the same entrance facility can be used for both interconnection and backhaul. *Pacific Bell*, 621 F.3d at 842, Pet. App. 8a.

The Telecommunications Act of 1996 and the FCC's Implementing Orders. Congress addressed interconnection in the Act. 47 U.S.C. §§ 201 *et seq*. (2011). The Act was designed to foster rapid development of competition in local telecommunications services by requiring ILECs, such as AT&T

California, to share their networks with competitors seeking entry into the traditionally monopolistic local service market. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999).

Pursuant to section 251 of the Act, ILECs must provide interconnection for the CLECs' facilities and equipment "at any technically feasible point within the [ILEC's] network." 47 U.S.C. § 251(c)(2). As described above, interconnection is the "physical linking of two networks for the mutual exchange of traffic." *Local Competition Order* (*LCO*)[4] ¶ 176; 47 C.F.R. § 51.5 (2011). *See also* 47 C.F.R. § 51.5 (defining "technical feasibility" in broad terms), § 51.321 (listing some examples of technically feasible interconnection).[5]

Separate and distinct from the interconnection obligation, ILECs also must provide CLECs with access to the ILECs' "unbundled network elements," *e.g.*, loops (the wires that connect telephones to switches), switches, and transport facilities. 47 U.S.C. § 251(c)(3). This requirement allows competitors to lease parts of the ILECs' networks so that the competitors can compete with the ILECs without building their own separate networks at significant expense.

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[4] First Report & Order, *Implementation of Local Competition Provisions in Telecomms. Act of 1996*, 11 FCC Rcd. 15499 (1996) (subsequent history omitted).

[5] In its petition, AT&T California does not address (much less discuss the significance of) section 251(c)(2) of the Act. *See* Pet. for Writ of Cert. 2-5.

To determine what network elements ILECs must make available under section 251(c)(3), the FCC must consider whether the failure to provide access to the network elements would "impair" the CLEC's ability to provide telecommunications service. *Id.* § 251(d)(2).

The rates ILECs charge for section 251(c)(2) interconnection and section 251(c)(3) access to unbundled network elements must be based on the ILECs' cost. *Id.* § 252(d)(1). Pursuant to FCC rules, ILECs must use a pricing methodology known as "total element long-run incremental cost," or TELRIC. *See* 47 C.F.R. § 51.505(b); *Verizon Commc'ns v. FCC*, 535 U.S. 467, 523 (2002) (upholding TELRIC).

The FCC implemented these provisions of the Act in the 1996 *LCO*,[6] the 2003 *Triennial Review Order* (*TRO*),[7] and the 2005 *TRRO*.[8] In the *LCO*, the FCC broadly interpreted the section 251(c)(2) interconnection duty. In the *TRO*, the FCC distinguished between the interconnection and backhaul uses of entrance facilities and concluded that ILECs no longer needed to provide CLECs with entrance facilities used for backhaul on an unbundled basis under section 251(c)(3).

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[6] *See supra* note 4.

[7] Report & Order & Order on Remand & Further Notice of Proposed Rulemaking, *Review of Section 251 Unbundling Obligations of Incumbent Local Exch. Carriers*, 18 FCC Rcd. 16978 (2003) (subsequent history omitted).

[8] *See supra* note 2.

Finally, in the *TRRO*, the FCC confirmed that it was eliminating the ILECs' duty under section 251(c)(3) to provide CLECs with entrance facilities used for backhaul. *See TRRO* ¶¶ 138-141; 47 C.F.R. § 51.319(e)(2)(i). In contrast, with regard to interconnection facilities, the FCC stated:

> We note in addition that our finding of non-impairment with respect to entrance facilities *does not alter the right of competitive LECs to obtain interconnection facilities pursuant to Section 251(c)(2)* for the transmission and routing of telephone exchange service and exchange access service. [n.394 *Triennial Review Order*, 18 FCC Rcd at 17204, para. 366.] Thus, competitive LECs *will have access to these facilities at cost-based rates to the extent that they require them to interconnect with the incumbent LEC's network*.

TRRO ¶ 140 (emphasis added).

The Proceedings Below. Following issuance of the *TRO* and the *TRRO*, AT&T California and a number of CLECs sought to negotiate changes to their interconnection agreements in California. The parties were unable to agree on all issues, and AT&T California initiated a consolidated arbitration proceeding at the CPUC pursuant to section 252(b) of the Act.

In 2006, the CPUC issued a decision requiring AT&T California to provide the CLECs with entrance facilities used for interconnection at cost-based rates pursuant to section 251(c)(2) of the Act, the *TRO*, and

the *TRRO*. Pet. App. 84a-86a. In 2007, the CPUC denied rehearing of its decision with regard to the entrance facility issue. Pet. App. 74a-79a.

AT&T California filed an action in the United States District Court for the Northern District of California, seeking review of the CPUC's decision. On cross-motions for summary judgment, the district court ruled in the CPUC's favor. *Pacific Bell Tel. Co. v. California Pub. Utils. Comm'n*, No. 07-1797, 2008 WL 501390, at *6-7 (N.D. Cal. Feb. 21, 2008), Pet. App. 58a-61a. The Ninth Circuit affirmed the district court's decision in March 2010. *Pacific Bel Tel. Co. v. California Pub. Utils. Comm'n*, 597 F.3d 958, 965-69 (9th Cir. 2010), Pet. App. 32a-40a.

Just days before the Ninth Circuit issued its decision, the Sixth Circuit – in a case addressing the same entrance facility issue, with the same factual background and procedural posture – issued its split decision ruling the opposite way. *Michigan Bell Tel. Co. v. Covad Commc'ns Co.*, 597 F.3d 370 (6th Cir. 2010). In September 2010, the Ninth Circuit denied AT&T California's petition for rehearing and issued an amended decision "reject[ing] the reasoning advanced by AT&T and the Sixth Circuit in its recent 2-1 decision." *Pacific Bell*, 621 F.3d at 844, Pet. App. 12a-13a.

On December 10, 2010, this Court granted certiorari in the Sixth Circuit case on the same entrance facility issue. *See Talk America*, No. 10-313, & *Isiogu*, No. 10-329. AT&T California filed this petition for a

writ of certiorari on December 23, asking the Court to hold the petition pending the Court's decision in *Talk America* and *Isiogu*. *See* Pet. for Writ of Cert. 7. By letter to the Clerk of the Court dated January 10, 2011, the CPUC and its Commissioners waived their brief in opposition to the petition in light of the Court's grant of certiorari in *Talk America* and *Isiogu*.

On February 3, 2011, the CPUC filed an amicus brief on the merits in support of the petitioners in *Talk America* and *Isiogu* with regard to the entrance facility issue. Br. Amicus Curiae of CPUC, *supra* at 3. By letter dated February 18, 2011, the Court requested that the CPUC file a response to this petition, despite the CPUC's waiver. Oral argument in the *Talk America* and *Isiogu* cases is scheduled for March 30, 2011.

ARGUMENT

I. THE COURT SHOULD HOLD THE PETITION PENDING THE COURT'S DECISION IN *TALK AMERICA* AND *ISIOGU*

The CPUC and its Commissioners believe the Ninth Circuit reached the correct decision. *See infra* § II. However, in light of the identical nature of the entrance facility issue in both this petition and the *Talk America* and *Isiogu* petitions, it is appropriate for the Court to hold this petition pending the Court's decision in *Talk America* and *Isiogu*.

In 2008, both the Seventh and Eighth Circuits held that, pursuant to section 251(c)(2) of the Act and

the implementing FCC orders, ILECs must provide CLECs with entrance facilities at cost-based rates, when the CLECs wish to use the entrance facilities for the purpose of interconnection. *Southwestern Bell Tel., L.P. v. Missouri Pub. Serv. Comm'n*, 530 F.3d 676, 683-84 (8th Cir. 2008); *Illinois Bell Tel. Co. v. Box*, 526 F.3d 1069, 1071-72 (7th Cir. 2008). In a split decision in February 2010, the Sixth Circuit took the opposite view, holding that ILECs were under no obligation to provide any entrance facilities – regardless of the use – and rejecting the Michigan Public Service Commission's decision that CLECs have a right to entrance facilities used for interconnection pursuant to section 251(c)(2). *See infra* § III. The Ninth Circuit then issued its decision, agreeing with the Seventh and Eighth Circuits.

On December 10, 2010, the Court granted certiorari in the Sixth Circuit in *Talk America* and *Isiogu*. AT&T California filed its petition for a writ of certiorari in this case on December 23, 2010.

The entrance facility question presented in both the *Talk America* and *Isiogu* cases and this case is identical: whether section 251(c)(2) of the Act and the implementing FCC orders require ILECs to lease their entrance facilities to CLECs at regulated, cost-based rates when the CLECs use the entrance facilities for the purpose of interconnection. The factual backgrounds of the cases are the same as well, as they deal with ILECs' provision and pricing of the same piece of telecommunications equipment: an entrance facility.

Finally, the procedural postures of the cases are also the same: (1) a state commission originally decided the issue; (2) the state commissions both ruled that ILECs must provide CLECs with entrance facilities used for interconnection at cost-based rates pursuant to section 251(c)(2); (3) the ILECs challenged the state commissions' decisions under section 252(e)(6) as an appeal based on an administrative record; and (4) the district courts resolved the issue via cross-motions for summary judgment.[9] For these reasons, the CPUC and its Commissioners respectfully request the Court to hold AT&T California's petition until resolution of *Talk America* and *Isiogu*, oral argument for which is scheduled for March 30, 2011.

II. THE SEVENTH, EIGHTH, AND NINTH CIRCUITS REACHED THE CORRECT RESULT

As the CPUC set forth in its amicus brief in *Talk America* and *Isiogu*, the Ninth Circuit – along with the Seventh and Eighth Circuits before it – properly concluded that ILECs must provide their entrance facilities to CLECs at cost-based rates to allow the customers of each to talk to one another. Section 251(c)(2) of the Act requires ILECs to provide CLECs with interconnection at cost-based rates, and an

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[9] The only difference is that the Ninth Circuit agreed with the CPUC, while the Sixth Circuit disagreed with the Michigan Public Service Commission.

entrance facility is just such a piece of equipment used to achieve interconnection – *i.e.*, a physical link between networks. *Pacific Bell*, 621 F.3d at 844, Pet. App. 13a. *See* Br. Amicus Curiae of CPUC at 13-15, *supra* at 3.

The FCC's implementing orders support this interpretation. First, in the *LCO*, the FCC broadly interpreted the section 251(c)(2) interconnection duty to require ILECs to provide CLECs a wide range of physical facilities CLECs can use to interconnect their networks with the ILECs' networks, at locations of the CLECs' choosing. *Pacific Bell*, 621 F.3d at 845-46, Pet. App. 16a. *See* Br. Amicus Curiae of CPUC at 16-22, *supra* at 3. In the subsequent *TRO*, the FCC took that broad interconnection duty and articulated a specific duty with regard to entrance facilities. *Pacific Bell*, 621 F.3d at 846, Pet. App. 16a-18a. The FCC concluded that ILECs no longer had to provide entrance facilities used for backhaul on an unbundled basis under section 251(c)(3), but did not touch the ILECs' duty to provide entrance facilities used for interconnection under section 251(c)(2). *Id.*, Pet. App. 17a. *See* Br. Amicus Curiae of CPUC at 22-25, *supra* at 3.

Ultimately, in the *TRRO*, the FCC found CLECs without access to entrance facilities to be unimpaired and thus declassified entrance facilities used for backhaul as an unbundled network element under section 251(c)(3). The FCC continued to recognize the two different uses of entrance facilities, however, and, in paragraph 140, explicitly reaffirmed that its

unbundling decision under section 251(c)(3) did not affect the section 251(c)(2) requirement (interpreted by the FCC in the *LCO* and the *TRO*) that ILECs provide interconnection facilities at cost-based rates. *Pacific Bell*, 621 F.3d at 845, Pet. App. 15a-16a. *See* Br. Amicus Curiae of CPUC at 26-33, *supra* at 3. The Ninth Circuit, therefore, reached the correct conclusion.

III. THE SIXTH CIRCUIT ERRED IN HOLDING THAT AN ILEC'S ONLY DUTY IS TO ALLOW A CLEC TO "PLUG IN" ITS OWN EQUIPMENT INTO THE ILEC'S NETWORK

The Sixth Circuit rejected the reasoning of the Seventh, Eighth, and Ninth Circuits. Instead, the panel majority concluded that paragraph 140 of the *TRRO* merely provides that, if a CLEC builds its own entrance facility, the ILEC must let the CLEC hook that entrance facility up to the ILEC's network by providing a different "interconnection facility" – nothing more than a place for the CLEC to "plug in" – at regulated rates. As the CPUC explained in its amicus brief in *Talk America* and *Isiogu*, however, the panel majority not only made a number of analytical errors, but also improperly substituted its own definition of entrance facility in place of the FCC's.

First, the panel majority mistakenly concluded that an entrance facility used for interconnection is not a type of interconnection facility – *i.e.*, that the FCC used the terms "entrance facilities" and "interconnection facilities" to refer to different pieces of

equipment. *See* Br. Amicus Curiae of CPUC at 33-35, *supra* at 3. Second, the panel majority improperly read the FCC's regulation eliminating the unbundling requirement (47 C.F.R. § 51.319(e)(2)(i)) to mean that the FCC had removed the ILECs' duty to provide *all* entrance facilities, regardless of how the CLEC uses them, thus collapsing the section 251(c)(2) interconnection and section 251(c)(3) unbundling obligations. *See* Br. Amicus Curiae of CPUC at 35-37, *supra* at 3; *Pacific Bell*, 621 F.3d at 845, Pet. App. 15a ("the duties of incumbent LECs under 47 U.S.C. § 251(c)(2) and § 251(c)(3) are independent").

Third, the panel majority erroneously rejected the distinction between the backhaul and interconnection uses of entrance facilities, as the FCC laid out in the *TRO*. *See Pacific Bell*, 621 F.3d at 846 n.15, 841 (explaining that *TRO* paragraphs 365 and 366 regarding entrance facilities' interconnection and backhaul uses are still good law), Pet. App. 18a n.15, 7a. *See* Br. Amicus Curiae of CPUC at 37, *supra* at 3.

Finally, in ultimately concluding that all an ILEC must do under section 251(c)(2) is make a "plug-in" location available to the CLEC, and not provide any actual equipment to facilitate that connection, the panel majority improperly limited that CLEC's interconnection choices, in direct conflict with both the Act and the FCC's orders. No longer is a CLEC able to interconnect via "any technically feasible" method under the statute; rather, the ILEC is given the power to choose whether a piece of equipment is an

entrance facility or an interconnection facility. *See* Br. Amicus Curiae of CPUC at 38, *supra* at 3.

CONCLUSION

For the reasons stated above, the CPUC respectfully requests the Court to hold AT&T California's petition pending the Court's decision in *Talk America* and *Isiogu* on the same issue.

Respectfully submitted,

March 21, 2011

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APPENDIX

ADDITIONAL STATUTORY AND REGULATORY PROVISIONS INVOLVED

47 C.F.R. § 51.5 (excerpt):

§ 51.5 Terms and definitions.

Terms used in this part have the following meanings:

* * *

Technically feasible. Interconnection, access to unbundled network elements, collocation, and other methods of achieving interconnection or access to unbundled network elements at a point in the network shall be deemed technically feasible absent technical or operational concerns that prevent the fulfillment of a request by a telecommunications carrier for such interconnection, access, or methods. A determination of technical feasibility does not include consideration of economic, accounting, billing, space, or site concerns, except that space and site concerns may be considered in circumstances where there is no possibility of expanding the space available. The fact that an incumbent LEC must modify its facilities or equipment to respond to such request does not determine whether satisfying such request is technically feasible. An incumbent LEC that claims that it cannot satisfy such request because of adverse network reliability impacts must prove to the state commission by clear and convincing evidence that such interconnection, access, or methods would result in specific and significant adverse network reliability impacts.

* * *

47 C.F.R. § 51.505:

§ 51.505 Forward-looking economic cost.

(a) *In general.* The forward-looking economic cost of an element equals the sum of:

(1) The total element long-run incremental cost of the element, as described in paragraph (b); and

(2) A reasonable allocation of forward-looking common costs, as described in paragraph (c).

(b) *Total element long-run incremental cost.* The total element long-run incremental cost of an element is the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's provision of other elements.

(1) *Efficient network configuration.* The total element long-run incremental cost of an element should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers.

(2) *Forward-looking cost of capital.* The forward-looking cost of capital shall be used in calculating the total element long-run incremental cost of an element.

(3) *Depreciation rates.* The depreciation rates used in calculating forward-looking economic costs of elements shall be economic depreciation rates.

(c) *Reasonable allocation of forward-looking common costs.*

(1) *Forward-looking common costs.* Forward-looking common costs are economic costs efficiently incurred in providing a group of elements or services (which may include all elements or services provided by the incumbent LEC) that cannot be attributed directly to individual elements or services.

(2) *Reasonable allocation.*

(i) The sum of a reasonable allocation of forward-looking common costs and the total element long-run incremental cost of an element shall not exceed the stand-alone costs associated with the element. In this context, stand-alone costs are the total forward-looking costs, including corporate costs, that would be incurred to produce a given element if that element were provided by an efficient firm that produced nothing but that given element.

(ii) The sum of the allocation of forward-looking common costs for all elements and services shall equal the total forward-looking common costs, exclusive of retail costs, attributable to operating the incumbent LEC's total network, so as to provide all the elements and services offered.

(d) *Factors that may not be considered.* The following factors shall not be considered in a calculation of the forward-looking economic cost of an element:

(1) *Embedded costs.* Embedded costs are the costs that the incumbent LEC incurred in the past and

that are recorded in the incumbent LEC's books of accounts;

(2) *Retail costs.* Retail costs include the costs of marketing, billing, collection, and other costs associated with offering retail telecommunications services to subscribers who are not telecommunications carriers, described in § 51.609;

(3) *Opportunity costs.* Opportunity costs include the revenues that the incumbent LEC would have received for the sale of telecommunications services, in the absence of competition from telecommunications carriers that purchase elements; and

(4) *Revenues to subsidize other services.* Revenues to subsidize other services include revenues associated with elements or telecommunications service offerings other than the element for which a rate is being established.

(e) *Cost study requirements.* An incumbent LEC must prove to the state commission that the rates for each element it offers do not exceed the forward-looking economic cost per unit of providing the element, using a cost study that complies with the methodology set forth in this section and § 51.511.

(1) A state commission may set a rate outside the proxy ranges or above the proxy ceilings described in § 51.513 only if that commission has given full and fair effect to the economic cost based pricing methodology described in this section and § 51.511 in a state

proceeding that meets the requirements of paragraph (e)(2) of this section.

(2) Any state proceeding conducted pursuant to this section shall provide notice and opportunity for comment to affected parties and shall result in the creation of a written factual record that is sufficient for purposes of review. The record of any state proceeding in which a state commission considers a cost study for purposes of establishing rates under this section shall include any such cost study.